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The South African Currency and Exchange Problem Re-examined

BY

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PREFACE.

The desirability of reaching at an early date a decision as to whether it is advisable that specie payments should be resumed by 30th June, 1923, as laid down in the Currency and Banking Act, 1920, makes it necessary to review the currency question as a whole.

Having, at the request of the Prime Minister, re-examined the subject and having recently presented my report to the Government, I am publishing it in the hope that it may be helpful to the general public in forming a judgment of a subject which closely concerns every member of the community.

I am indebted to Mr. Joseph Kitchin for the help he has given me by preparing the statistical data required for the consideration of this question.

H. STRAKOSCH.

JOHANNESBURG,

December, 1921

The South African Currency and Exchange Problem Re-examined.

I.

The Currency and Banking Act, 1920, provides in Section 7 (1) that "whenever the market price of gold in the Union exceeds three pounds seventeen shillings and tenpence half-penny per standard ounce the Governor-General may, by Proclamation in the *Gazette*, declare that the redemption of gold certificates is suspended while such excess continues", and further in Sub-section 3 of the same clause that "the provisions of this Section shall not remain in operation after the 30th day of June, 1923."

The gold certificates created under the Act thus become redeemable in gold specie on demand as from that date, while the prohibition of the export of gold under the Moratorium Extension Act No. 38 of 1920, will cease to operate at the expiry of that Act in 1922. Unless Parliament decides otherwise, therefore, South African currency will become convertible into gold and exportable in that form as from 30th June, 1923, and the country would then resume specie payments, or, in other words, revert to the effective gold standard.

The question as to whether it was advisable or possible for South Africa to revert to the effective gold standard was considered by a Select Committee of the Legislative Assembly in April and May, 1920. The conclusions of the

Committee were embodied in its report of 22nd June, 1920, and may be summarised as follows:—

> The removal of the embargo on the export of specie, and the consequent raising of the exchange value of Union currency to a parity with gold is bound to have a seriously prejudicial effect upon the agricultural and manufacturing industries of the country, and in the case of the gold mining industry a disastrous effect, because the consequent fall in prices of our industrial product would be immediate, while the cost of production could not simultaneously be reduced in proportion. It would, moreover, encourage an efflux of capital from and discourage the entry of capital into South Africa, and therefore restrict facilities for the development of the country. While the Committee was satisfied that the effective gold standard was the soundest and best system of currency, it was of opinion that the process of restoration to that system must be gradual, and that it was not practicable to fix any definite time-limit for its re-enactment, for that depended upon the rest of the world as much as upon our own economic position.
>
> The Committee concluded that, in the surrounding circumstances, the exchange value of our currency could not be maintained on a parity with gold. There was, therefore, great danger that, if the embargo on the export of gold were removed, the country would be completely denuded of its specie reserves, and that a grave financial crisis would ensue.

In view of the provisions of Section 7 (Sub-section 3) of the Act, it becomes necessary to examine the subject afresh, with a view to determining whether conditions have undergone, or are likely to undergo, changes in the direction of making it possible for the Union to resume specie payments by the end of June, 1923. It is well that this examination should be undertaken at as early a date as possible, for nothing could be more detrimental to the

economic life of the country than the unsettling influence which uncertainty on so vital a change in the monetary policy of the country is bound to produce.

It is my purpose, in this paper, to review the subject in the light of general conditions as we find them to-day and as they are likely to obtain in a future which lies probably far beyond 30th June, 1923, and also in the light of comments which were made on the conclusions of the Select Committee last year.

The resumption of specie payments in South Africa involves the raising to, and the maintenance at, a parity with gold of the exchange value of Union currency. The only other country which enjoys an effective gold standard to-day being the United States of America, the exchange value of the South African pound will, for all practical purposes, have to remain on a parity with the United States dollar, that is, one South African pound will have to reach and maintain an exchange value of $4.866.

It should be noted, however, that once or twice in the more recent past gold commanded a somewhat higher price in London for shipment to India than was indicated by the price of United States dollars. But since India has opened its frontiers to an unrestricted import of gold on private account, the increased price India would be prepared to pay will be the difference between the greater cost of transport, loss of interest, etc., from the United States to India and the lower cost of these items if it draws its gold requirements from London or South Africa. To that extent South African currency may have to rise above the dollar parity.

Generally, it may be said, therefore, that as the exchange value of the South African pound will have to be maintained on a parity with the United States dollar, currencies of other countries in terms of the South African pound will move on very similar lines to those on which they move in relation to the United States dollar.

It is important to observe the effect of this on the exchange movements of the English pound in relation to the South African pound, for South Africa's foreign trade is predominantly with the United Kingdom, and because the foreign trade of the Union plays so important a part in its economic life. A study of the relative importance of South Africa's home and foreign trade made by the writer early in 1920 led to the conclusion, which was laid before the Select Committee, that no less than 35% to 40% of the Union's total trade was with foreign countries (mainly with the United Kingdom). By way of comparison, it may be mentioned that similar calculations for the United Kingdom and India have shown that the percentage of foreign trade to total trade is some 16% to 20% in the former and some 6% in the latter.

Though figures of this kind can only be regarded as mere approximations, they nevertheless enable one to form a sufficiently accurate picture to appreciate the very important place which the foreign trade of the Union occupies in its economic life. Stability must be the aim of all monetary policy, and the establishment of stability of the exchange with the country with which the Union carries on the greatest part of its foreign trade is of the utmost importance to its economic well-being. The smaller the fluctuations, the easier will it be to carry on this trade, and therefore the greater and the more profitable will it be.

The attached chart illustrates graphically the movements of the New York and South African exchanges in relation to London. It shows how wide are the former and how very steady the latter. It also shows that, especially since March of last year, the South African exchange on London maintained almost complete stability, its fluctuations being confined to a range of only about 1%. There are few countries in the world to-day which have the advantage of being able to transact the major portion of their foreign trade in similar conditions of stability.

II.

Those who opposed the Currency and Banking Act, 1920, and advocated the removal of the embargo on the export of gold and the resumption of specie payments at a fixed and early date, did so mainly on the ground "That the currency of South Africa has been inflated by the excessive issue of bank notes which has forced up the cost of living," and "That the cost of living in South Africa will continue to advance so long as the quantity of paper money in circulation remains redundant." (Mr. Samuel Evans before the Select Committee.)

With regard to the establishment of the South African Reserve Bank, whose charter was modelled on the lines of the Federal Reserve system of the United States of America, they objected "That the Federal Reserve system is still in the experimental stage, and is held to have been largely responsible for the inflation of the currency and the high cost of living . . . . and that the Government and Parliament of the Union would be well advised not to attempt anything but purely restrictive legislation as regards future paper money in South Africa."

There never was any solid ground for the assertion that the note circulation of the Union was redundant, and those claiming that it was never attempted to justify this assertion. There was, on the contrary, fairly reliable evidence to show that it was not redundant. Gold having for all practical purposes disappeared from circulation, the medium of exchange of the Union was, apart from the token coins, the bank note. The total bank note circulation of the Union on 31st March, 1920, was £8,900,000, or around 26/6 per head of population, and if one were to add the token coins in circulation this would only add a few shillings per head. The circulation of all forms of money in the United Kingdom before the War was estimated to have exceeded 80/- per head of the population. Making all possible allowance for

the fact that the native population of the Union represents three-quarters of the total population, the difference of the figures quoted above is so glaring as to furnish pretty reliable evidence that the assertion of redundance in the South African circulation has no foundation in fact. And that is especially so if it is remembered that the figure quoted for the United Kingdom circulation referred to a time when prices in that country were only about one-half of what South African prices were early in 1920, and that the use of money as a medium of exchange in England is notoriously small in view of the very high state of development of the cheque system in that country.

The view that there was a redundance of the bank note circulation in South Africa, and that prices in the Union would rise because of such redundance, was combated by the writer. Indeed, he urged upon the Select Committee the advisability of hastening to establish the South African Reserve Bank so as to be in readiness to meet an emergency, "for commodity prices are bound to come down, and falling prices always mean crises". That view was accepted by the Select Committee, and later on by Parliament when it passed the Currency and Banking Act, and events have proved that they were right in doing so.

But those who opposed the Act went much beyond the contentions just mentioned. They claimed that it was possible to control the course of the South African exchange by regulating the amount of the monetary circulation, and, relying upon that contention, maintained that specie payments could be resumed at a definite and early date without reference to what surrounding international conditions might be. They relied upon the "orthodox doctrine":—

(*a*) That a currency or unit of account is valued for what it is worth, that is, for the commodities and services which it will buy, and

(*b*) That variations in the supply of an article, to which currency is no exception, affects its value or power of buying, increases tending to reduce and decreases to raise its value; and consequently

(*c*) That the exchange between currencies can be kept close to a given rate by due regulation of their supply.

The theory sets forth, in other words, that the value of a foreign currency in terms of our own money depends upon the relative power of those currencies to purchase goods and services in the respective countries, and further that the respective purchasing power of the moneys of the two countries determines the ratio of exchange between them. The eminent Swedish economist, Professor Gustav Cassel, tersely calls the level of exchange so determined the "purchasing power parity". But it is a notorious fact—and no one who has given close thought to the subject could help appreciating it—that violent deviations of the exchanges from their purchasing power parity are taking place, and are bound to continue to do so in view of the complete absence of an equilibrium in the economic and monetary conditions of the world and the many hindrances to international trade.

The theory of the "purchasing power parity" can merely be the statement of a tendency, and can never pretend to be anything else. The purchasing power parity represents nothing more than the centre of gravity towards which exchanges tend to move because of the ever-present desire of people to buy in the cheapest market. It is around this centre of gravity that the exchanges oscillate. To say that there is a centre of gravity and that there are forces tending to move exchanges towards it blurs the picture rather than throws light upon it, for it suggests that, in spite of present-day conditions, the forces tending to drive the exchanges to the centre of gravity continue to be so immensely more powerful than the forces causing the

deviation that the latter call for little consideration. Our problem cannot be solved except by a due recognition of their importance, and by a close study of their origin, nature and effect. It is claimed as a consequence of contentions (*a*) and (*b*) quoted above that the problem will be solved by due regulation of the supply of the currencies of the two countries.

It is well first to examine from the experience of the immediate past how close the co-relation is both as to extent and time between the supply of currency and prices. In the attached table (Appendix A) are set out in tabulated form figures of the note circulation and wholesale prices of commodities of the United States, the United Kingdom and the Union of South Africa at three-monthly intervals from 31st December, 1919, to 30th June, 1921. In order to make the picture clearer and more instructive, the movements are also shown on a percentual basis, taking both the maximum circulation and the maximum prices attained during that period as being 100%. It will be seen that, so far as South Africa is concerned, maximum prices were reached in July, 1920, while the maximum note circulation was attained at 31st December, 1920. The commencement of the fall in prices, in other words, preceded the maximum note circulation, and did not follow it, there being a lag of some five and a half months between the two events. It will be observed, further, that the phenomenon is not peculiar to South Africa, but that it can also be noted with regard to the United States and the United Kingdom, with this difference, however, that the commencement of the fall in prices preceded the maximum of currency circulation in the United Kingdom by seven and a half months.

This seems sufficiently to dispose of the idea that the variation in the supply of currency in circulation reacts so nicely upon prices in present-day circumstances as to make it possible to control the movement of the latter by regulating the supply of the former.

Before the war the theory was successfully applied in India. Its complete failure since then, however, in spite of gigantic efforts made by the Government of India to maintain it, is eloquent proof that the system does not operate in all circumstances, but that it requires for its satisfactory working certain definite conditions.

It is useful to appreciate the efforts made by India towards stabilising her exchange on London. In her attempt to counteract the fall in the sterling value of the rupee, the Government of India, within the short period of eight months (from 1st February to 30th September, 1920) sold remittances on London (Reverse Council Drafts) to the value of no less than £50,000,000 sterling. The attempt at stabilisation nevertheless failed completely, and caused the Indian Exchequer a loss amounting to a round £7,500,000. The Minister of Finance of India, when introducing the Budget for 1921-22, frankly admitted the failure, and went so far as to say that the "great disparity between the market rate and the 2/- gold rate became so great that it would have been necessary for us to have sold Reverse Councils to an almost unlimited extent". Large amounts of these remittances notoriously represented repatriated or exported capital from India. The attention of the Select Committee was drawn to the danger of this happening, and the experience of South Africa in the same direction, when the exchange value of its currency rose to the neighbourhood of 8%, should be recalled.

III.

The indispensable conditions for the functioning of the before-mentioned theory are the possibility of regulating prices effectively by controlling the supply of currency, and the certainty that an alteration in the level of prices will lead to a corresponding movement of goods. These conditions can only exist when there is an almost complete equilibrium in the general level of prices. That pre-supposes stability in the monetary systems and a close co-ordination of monetary policies.

That equilibrium has been utterly destroyed by the consequences of the war, and, though economic forces tend to re-establish it, much has to happen before it is restored. Not only is there disequilibrium in the general level of prices, but the equilibrium in the relative values of various commodities, *inter se*, is completely upset, and similarly the relationship of wages and prices. Stability in the monetary systems and uniformity of monetary policies are notoriously also absent in all but a very few countries.

An alteration in the general level of prices will only lead to a movement of goods from one country to another if the alteration actually affects the prices of the particular goods each country is in a position to export, and if there are no impediments to the free exchange of goods. The relationship of prices of goods, *inter se*, being grievously upset, the rise or fall of one class of goods often does not, in the existing circumstances, sympathetically affect other classes of goods.

To appreciate this it is only necessary to think of the impoverishment of a vast section of Europe's population. The production of many classes of goods which formerly found a ready market amongst that population will but gradually adjust itself to the new conditions of largely curtailed purchasing power. Only when this adjustment has taken place, when accumulated stocks have been consumed, and when increased savings will again permit a greater proportion of capital goods to be absorbed, can we expect equilibrium in the relative prices of commodities to return, and only then will an alteration in the general level of prices produce that sympathetic movement over the whole range of goods to which we were accustomed before the war.

While the general level of prices in the countries that have put a stop to monetary inflation is tending towards equilibrium, that is not the case in countries which continue to inflate their currencies. This will be more clearly seen from the subjoined table, in which are tabulated the whole-

sale prices of commodities at half-yearly intervals from December, 1919, to June, 1921, reduced to a gold basis, and taking the average prices for 1913 as 100:—

	Germany.	Italy.	France.	United Kingdom.	United States.
Dec., 1919 ...	104	183	211	215	238
June, 1920 ...	157	189	203	236	269
Dec., 1920 ...	96	115	133	158	189
June, 1921 ...	84	131	136	140	148
Aug., 1921 ...	86	121	134	134	152

There is no need to enlarge upon the disequilibrium between wages and prices. The vast amount of unemployment in some countries sufficiently emphasises that fact, but it is well to draw attention to the extraordinary disparity of wages in many European countries. The London *Times* reproduced some little time ago a table prepared by the Swiss Bank Corporation, in which are compared the wages in the machinery and metal trade in various countries as at the end of December, 1920. To bring them on to a common basis, they have been converted into Swiss francs at the then rates of exchange:—

	Wages per hour.	Equivalent in Swiss currency.
Austria	33·6 kronen	f. 0·51
Germany	6·26 marks	f. 0·54
Italy	2·58 lire	f. 0·59
Belgium	2·80 francs	f. 1·10
France	2·57 francs	f. 1·12
Switzerland... ...	1·75 francs	f. 1·75
England	2s. 2d.	f. 2·10

The absence of a uniform monetary policy by all but a few countries is patent to all. The notable exceptions are

the United Kingdom and the United States, which are known to be in the closest touch with one another through their central banks, and it cannot be doubted that it will be the policy of the South African Reserve Bank to establish contact with these institutions and to conform closely to their policy. This would seem the most appropriate manner in which the re-establishment of equilibrium in monetary affairs can be fostered and the way prepared for the resumption of an effective gold standard. The re-establishment of equilibrium must precede the resumption of specie payment and cannot follow it.

IV.

If South Africa is to resume specie payments, we must be certain that it will be able to maintain its exchange at all times on a parity with gold. The deviations from the gold point must not be greater than the cost (including loss of interest, insurance, etc.) of transporting specie from South Africa to the country receiving it. If it exceeds this limit and leads to the shipment of specie abroad, we must be certain that the reaction which a variation in the volume of the Union's monetary circulation produces on prices in the Union, and the reverse reaction which a corresponding variation in the monetary circulation in the other country produces on its prices, will lead to re-establishing equilibrium without causing an undue drain upon our specie reserve. That will be possible only if the reactions on prices caused by the movement of specie are effective and immediate, and if the variation in the level of prices of the two countries leads promptly to a corresponding movement of goods.

Attention has been drawn to the absence of movement of the prices of certain goods in unison with the movement of the general level of prices. Let us observe the effect of this. Suppose that a rise in the general level of prices in South Africa leads to a drain of some of its specie reserves to the United States, and that, in consequence of the drain on South Africa and the flow into the United States of that

specie, prices fall in South Africa and rise in America, as they used to do before the war in similar circumstances. Of what possible use can the rise in general prices in America be in the direction of re-establishing equilibrium if the shipment of gold is insufficient to do so and if the only other things we can send her—mainly wool, ostrich feathers, and diamonds—do not participate in the rise of general prices in America and will therefore not be bought from us by America?

But let us also consider what influence the specie movement, provoked by such a set of circumstances, is likely to have upon the general level of prices in the United States. That country is already surfeited with gold. The holding of that metal by the Federal Reserve system amounts to some $2,711,000,000, equal to £557,000,000 at the par of exchange, and provides a reserve ratio to all liabilities of 68·7%. Applied to its note issue alone, it represents gold cover of those notes of no less than 115·7%. What possible influence can an inflow of the size of even the whole of our specie reserve (say, some £10,000,000) have upon the monetary situation, and therefore on prices, of that country? It is superfluous to say that to South Africa an outflow of anything approaching the limits of its specie reserve would spell disaster.

The great disparity in the relative size of specie reserves is a factor of great importance. The satisfactory working of the gold standard before the war was not a little due to the fact that gold reserves were relatively fairly evenly distributed amongst the gold standard countries. It is in no small measure due to this fact that the movement of a comparatively small amount of gold from the reserves of one country to those of the other had an immediate and pronounced effect in both countries. It was the automatic and simultaneous action and reaction in two countries, which were in an otherwise evenly balanced condition, that caused the disequilibrium in prices to be re-established so quickly.

When we resume specie payment, we must also be reasonably certain that we shall be able to restore our specie reserve in case of a drain upon it by inducing a reserve current of gold. The United States of America being now the only country which enjoys an effective gold standard, South Africa's ability to restore its specie reserves depends entirely upon its power to draw upon the specie reserves of America.

V.

We now come to a phase of the question the importance of which cannot be sufficiently emphasised.

If we resume specie payment the South African pound will be convertible into a sovereign containing 123·274 grains of standard gold and exportable in that form. It will, therefore, in these circumstances, buy abroad what 123·274 grains of gold will purchase there. If that purchasing power is applied to buying American money, it will always acquire $4·866, because 123·274 grains when handed in to the American Mint will coin $4·866. But if the purchasing power of the South African pound is applied to the purchase of goods or services, it may sometimes acquire more and sometimes less of the same commodities or services abroad than it will acquire at home. If it acquires more goods at home than 123·274 grains of gold will acquire abroad, its internal purchasing power will be greater than its external value, while, in the reverse case, its internal purchasing power will be smaller than its external value.

Before the war, when prices, wages and monetary values (most of the great trading nations were on a gold standard) were in a state of close adjustment, and when goods, gold and credit moved freely without hindrance, the internal and external value of the monetary units of these countries remained for all practical purposes equal, the variations being merely fractional. But to-day that close adjustment is lacking, and the freedom of trade seriously impeded. The monetary policies of most of these countries

call forth changes in the purchasing power of their monetary units of a violent character. Many countries on the Continent of Europe persist in increasing their monetary circulation, and with it their level of prices and wages (measured in terms of their currency), while the United States of America, the United Kingdom, South Africa, and a few other countries follow the policy of gradually increasing the value of their money, thus lowering their level of prices.

The manner in which the adjustment of prices and other conditions to these monetary changes proceeds deserves close attention. The prices of home-produced goods, and sometimes even of imported goods, but especially wages, adapt themselves sluggishly to the monetary changes. To appreciate this, we need merely think of the difficulty of making drastic changes in the scale of wages one way or the other, or of the hesitation of manufacturers and traders to make frequent and drastic changes in their prices. We may say then that the internal purchasing power adjusts itself only tardily to the changed monetary conditions. The external purchasing power, on the other hand, responds to monetary changes rapidly. It is essentially the business of the trader to anticipate the course of events. A German manufacturer employing copper for the manufacture of his goods, perceiving that Germany's monetary policy must lead to the value of the mark being reduced, will buy American dollars at the earliest possible moment with which to purchase either immediately or later on the copper he expects to require. An exchange dealer or speculator in Germany will buy dollars because he thinks he will be able to sell them later on for more marks. These and similar transactions (among them the heavy sales of mark notes abroad) tend to depreciate the external value of the mark rapidly. In countries, on the other hand, which follow the policy of raising the value of their monetary unit, traders will try to anticipate this by selling foreign currencies, with the effect that the external value of their money will be raised more rapidly than its internal purchasing power, the latter

depending upon the more sluggish reduction in the price of home-produced goods and wages. The difference in the rapidity with which monetary changes react upon the internal and external purchasing power of money—the sluggish movement of the internal value and the rapid response of the external value to the monetary changes—causes the strong deviations of the exchanges from their purchasing power parity. Germany's power to undersell most other industrial countries is mainly due to the monetary changes in her country tending to depreciate the value of her money and to the fact that this depreciation reacts more rapidly upon the external than upon the internal value of the mark. 850 German marks, which can now be bought for £1, will buy more goods in Germany than £1 will purchase of the same goods in England. To the people in England the internal value of a mark is greater than its external value, while to the Germans the internal value of the pound is smaller than its external value.

VI.

In the light of what is said above, what is likely to be the position in South Africa when specie payments are resumed? The monetary change will react rapidly on the external value and sluggishly on the internal value of our monetary unit. The external value will be raised rapidly to what 123·274 grains of standard gold or $4·866 will buy abroad, while the difficult process of reducing wages, the prices of stocks of commodities on hand, and the prices of new home-produced goods will cause the internal value of our money to rise very much more slowly. In these circumstances, the South African pound will buy fewer goods at home than it will buy elsewhere, but, being convertible into 123·274 grains of gold, it will be so converted and shipped abroad to pay for goods bought there. To the extent to which South African pounds are sent abroad our specie reserves will be depleted, and they will continue to be so depleted until the internal purchasing power of our money has been raised to a parity with its external value.

But even if we succeeded with a huge effort of deflation in bringing the internal and external value of our money rapidly to a common level, and without in this process crippling our industries, our problem is by no means solved. Our specie reserves are subject to attack whenever the internal purchasing power of the money of other countries rises above the internal purchasing power of our money, and that obviously depends as much upon changes in other countries as upon changes that may take place with us. If one remembers how violent the fluctuations are in other countries, owing to the confused monetary changes which are constantly taking place, one must surely have the gravest doubt of South Africa's ability to follow these changes so closely and so rapidly as to keep the internal purchasing power of her money at all times in close adjustment with the internal purchasing power of the moneys of other countries.

It will readily be appreciated how difficult and uncertain a process it is to achieve this if the deviation is anything more than a trifling one. But it is not only difficult and uncertain, it is also dangerous. In my paper on "The South African Currency and Exchange Problem", which formed the basis of my evidence before the Select Committee last year, attention was drawn to this and emphasis laid upon it:—"The want of coincidence of these two factors may well have a most serious effect upon all manner of production in the Union."

The position of the gold mining industry is a particularly difficult one. When specie payments are resumed, the industry will be receiving for every 123·274 grains of standard gold it produces one South African pound, or, if shipped to America, $4·866. That amount of dollars notoriously buys very considerably less to-day than it did in 1913, so that the South African pound on reaching the purchasing power parity of the dollar would, in present world conditions, also buy considerably less than it did in 1913. It is common knowledge that a substantial number of the mines on the Rand cannot operate profitably unless they

can acquire for every 123·274 grains of standard gold they produce an output of labour and a supply of materials which is not inferior to that of 1913, or, in other words, it must not cost more to treat a ton of ore than it did in 1913. That is illustrated by the subjoined figures. In order to restore the cost of production to the level at which it stood in 1913, it will be necessary for the average costs to be reduced by what they have risen since then, as follows:—

	1913.		1920.	Per cent.
* White wages, from ...	5/11	to	9/2	55%
Native wages, ,, ...	4/2	,,	4/11	18%
Stores, ,, ...	7/10	,,	11/6	47%
	17/11	to	25/7	43%

If the drastic adjustment to the lower level is not achieved within a very short time after the external value of the South African pound has reached parity with the dollar—that is, upon or before specie payments are resumed—a substantial proportion of the gold mining industry, not being able to produce profitably, will have to cease operations. The physical condition of many of the mines likely to be affected is such that, when operations have once ceased, it will be impossible to resume them later on. It is clear then that, so far as the gold mining

*The figures for 1921, which have become available since this report has been written, change the picture as follows:—

	1913.		1921.	Per cent.
White wages, from ...	5/11	to	8/8	46½%
Native wages, ,, ...	4/2	,,	4/10½	17 %
Stores, ,, ...	7/10	,,	11/10½	51½%
	17/11	to	25/5	42 %

industry is concerned, it would not be enough, on resuming specie payments, for the internal value of our money to reach its external value, but it would have to rise rather considerably above it if the poorer mines on the Rand are to be kept alive.

Enough has been said to show how powerful, complex and for us uncontrollable the forces are which dominate the problem, and how entirely inadequate the doctrine previously referred to is to guide us through the difficulties and complexities of the present situation. To rely upon it, and, on the strength of it, to resume specie payments in South Africa at a definite and early date would be disastrous.

VII.

In the course of the evidence given before the Select Committee last year, I dealt with the general question of re-establishing an effective gold standard in the existing monetary and economic conditions of the world. The Select Committee accepted the conclusion come to, viz., that "the true gold standard cannot exist in the present abnormal world conditions, except in unusually favoured circumstances such as obtain in the United States of America." This view found subsequent confirmation on the part of Dr. G. Vissering, the eminent banker and economist and Chairman of the Netherlands Bank of Amsterdam, who, as President of the Committee on Currency and Exchange of the International Financial Conference at Brussels, at the end of September, 1920, said in the course of his address before the main Conference as follows:—

> "Gold has . . . retained its function of cover for a fiduciary circulation, but, practically speaking, at the present moment it no longer plays the part of international medium of payment . . . Gold is no longer supplied, because it has lost its important quality of freely flowing in and out. Whoever now issues gold

is quite sure that it has gone for good, unless the rate of exchange should run up above that of America.

"If one were thus to issue gold as a means of payment to foreign countries, this would be done without there being any chance of seeing gold return from other directions, and the stock of gold would thus be exhausted.

". . . Such export would give the country an appearance of strength, though this would not be more than in appearance . . . The stock of gold would, however, be so rapidly exhausted that after a very few months the use of this medium of payment would be no longer possible, whereupon the great disillusion would follow. The country's own exchange would then drop so much the more, the price to be paid to foreign countries would increase so much the more, and the nation would be more rudely awakened from their dream that the level of prices in their own country had really not been so high.

"If it became known internationally that the Netherlands would begin to issue gold against imports without there being any chance of being able to replenish their gold stock in due course, the faith in the Dutch exchange would be immediately undermined; the guilder not only in bank notes, but also in the form of accounts current in the banks, would no longer be so well secured by precious metal. We should then see a 'sauve qui peut' with regard to the Netherlands also, foreigners would then try as much as possible to withdraw from the Netherlands the hundreds of millions of guilders which they have entrusted to the Netherlands, in order to convert them into some other currency before the guilder dropped too far.

"Precisely this fact would immediately force the fall of the guilder, and such an attack would be made on the guilder that even the present stock of gold would not be able to withstand it. Within a short space of time the guilder would have seriously depreciated, and the question of high prices for the Netherlands would then make itself felt two or three times as severely . . . Not only foreigners would withdraw their balances from the Netherlands, but persons residing in the country would want to buy largely foreign currencies before the guilder had depreciated too far; an exodus of capital would consequently take place. . .

"The function (of gold) of acting as an international medium of payment in order to span a temporary deficit in the balance of payment will eventually return of its own accord, when the world conditions are better regulated, and will then again be able to prove its great utility."

Professor Gustav Cassel, the great Swedish economist, in his "Second Memorandum on the World's Monetary Problems", which he quite recently (August, 1921) prepared for the League of Nations, comes to a similar conclusion. He says:—

"But a small country which accumulated a gold fund sufficient for occasional demands from its own internal market would find this fund quite insufficient for satisfying similar demands from abroad. If the country had been alone among European countries to restore the gold standard, it might quite easily see its whole gold fund suddenly exported to satisfy foreign demands for gold. For this reason, no small country can take the lead in the restoration of the gold standard in Europe. . .

"A real stability of the gold market can, in fact, never be obtained until the gold standard has been restored in several countries and actual gold payments have been resumed in a considerable part of the world."

VIII.

Taking the average quotation for the half-year ended 30th June, 1920, the South African pound showed then a depreciation in relation to gold (the dollar) of 24%. The six-monthly average to 31st October of this year shows a depreciation of 28%. What that depreciation will be on 30th June, 1923, no one will be bold enough to prophesy, though, taking a wide view of the situation and assuming no violent change in South Africa's monetary policy, the probability is that there will be a gradual appreciation of our monetary unit. We must never forget, however, that the situation is governed not solely by South Africa's monetary policy, but mainly by that of the other great trading nations, and that again is governed by the thousand and one things which go to shape their own policy. If the depreciation of the South African pound in relation to gold has not very materially diminished by 30th June, 1923, the measure of deflation necessary to raise its value to a parity with gold would be a formidable one. It would produce powerful reactions upon every branch of our economic activities. This was summarised last year in my evidence as follows:—

"The drastic reduction of prices of all stocks in the country, the calling in of loans, the sale of stocks and shares from abroad, the stoppage of the accustomed flow of capital from abroad, and the impeding influence upon all productive industries are the typical forces which make for a crisis. It is the kind of crisis,

born of unduly rapid deflation, which statesmen the world over strive to prevent, because of the disastrous effects—economic and political—it is liable to bring in its train."

The question of deflation naturally occupied the attention of the International Financial Conference at Brussels. Its unanimous resolution with regard to this subject cannot be sufficiently emphasised. It is couched in the following terms:—

> "The reversion to, or establishment of, an effective gold standard would in many cases demand enormous deflation, and it is certain that such *deflation, if and when undertaken, must be carried out gradually and with great caution;* otherwise the disturbance to trade and credit might prove disastrous."

It is perhaps well to add a few words by way of explanatory comment. The raising of the value of the monetary unit by a policy of monetary deflation (which the resumption of specie payment implies) involves primarily a drastic curtailment of credit, which would force the repayment of debts, and which would keep credit restricted even after previous liabilities have been liquidated. Debts can only be repaid out of the proceeds of realisation of accumulated wealth (mainly stocks of commodities) and out of future surplus production. To force the sale of stocks of commodities without due regard to the capacity of absorption by the market is obviously unwise, and as regards the future surplus production, no one can be certain what that will be, for it naturally depends upon circumstances of the most varied and variable kind. For these reasons a definite programme of the speed with which deflation can safely be undertaken cannot be laid

down. The measure of deflation must be closely co-ordinated to the surrounding and changing conditions.

It is evident, however, that the greater the production of the right kind the greater will be the surplus available for the redemption of debt and the easier and quicker will be the process of deflation. A monetary policy which tends to impede production can, therefore, not be regarded as sound. Nor will it be sound if it does not take full account of the human factor, however well it may otherwise conform to the teachings of political economy. Social and political considerations must constantly be kept in mind, and circumstances may arise which make these considerations the determining factor. To continue a drastic policy of deflation in the face of, for instance, seriously growing unemployment, and with it social unrest, would obviously not be sound. The economic body, as in the case of the human body, is capable of adapting itself to widely differing conditions if the change is brought about gradually, but disturbances—sometimes of a serious kind—are provoked if the change is sudden and violent.

There is no better way of guiding the financial policy of a country than through the medium of its central bank. The intimate touch which that bank maintains with the business of the country enables it intelligently to determine a policy, and to adjust it to circumstances as they change, to relax the pressure or to increase it in accordance with its judgment regarding the country's capacity to bear the strain, which especially a policy of deflation imposes. The importance which is being attached to the functions of a central bank is perhaps best illustrated by recalling the fact that the Brussels Conference laid it down in one of its resolutions that "In countries where there is no central bank of issue one should be established."

The conclusion is irresistible that the determinations of the Select Committee of 1920 are as sound and wise to-day as they were last year, and, in particular, that "it is not practicable to fix any definite time limit" for the resumption of specie payments. My recommendation is that full effect should be given to these determinations and that the Currency and Banking Act, 1920, should be amended accordingly by deleting Sub-section 3 of Section 7.

H. STRAKOSCH.

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